**COMMONWEALTH OF VIRGINIA, ex rel.**

**TERRY L. STROCK, et al.**

**CASE NO. PUE-2001-00716**

**v.**

**B&J ENTERPRISES, L.C.**

# REPORT OF HOWARD P. ANDERSON JR., HEARING EXAMINER

**December 19, 2002**

By letter dated October 26, 2001, B&J Enterprises, L.C. ("B&J" or the "Company") notified its customers and the State Corporation Commission's Division of Energy Regulation of its intent, pursuant to the Small Water or Sewer Public Utility Act,[1] to increase its monthly sewer rates from $40.00 to $95.00,[2] effective for service rendered on and after December 13, 2001. On November 21, 2001, the Commission received a petition from approximately 90% of the Company's customers objecting to the proposed rate increase.

On December 12, 2001, the Commission issued a Preliminary Order suspending the Company's proposed rates for 60 days.[3] The Preliminary Order further directed the Company and Staff to file a response to a claim raised by Joan G. Moore, a customer, asserting that B&J is barred by § 56-265.13:6 B of the Code of Virginia from implementing a rate increase until April 2002. In support of her claim, Ms. Moore stated that the Company's last rate increase was implemented in April of 2001; therefore, the Company may not raise its rates again until April of 2002.[4]

On January 30, 2002, the Commission issued an Order stating that "Section 56-265.13:6's prohibition on multiple rate increases within a twelve-month period is a limitation on the water or sewer public utility company, not on the Commission."[5] In permitting B&J to implement its proposed rate increase in this case, the Commission further stated:

> Our approval of final rates in March 2001 that differed from those proposed by the Company and implemented on an interim basis and subject to refund in September 1999 does not constitute a separate rate increase implemented by the Company within the meaning of §56-265.13:6 B.[6]

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[1]Section 56-265.13:1, et seq. of the Code of Virginia.

[2]At the hearing on July 14, 2002, counsel for the Company advised that the Company was reducing its rate increase request to $90.00 per month. (Tr. 23).

[3]Section 56-265.13:6 of the Code of Virginia provides that the Commission may suspend the proposed rates for no more than 60 days.

[4]Section 56-265.13:6 B states: "A small water or sewer utility shall not implement an increase in the utility's rates or charges more than once within any twelve-month period."

[5]Order at 4.

[6]Order at 5.

The Order authorized B&J to implement its proposed rates effective February 11, 2002, on an interim basis and subject to refund with interest. The Commission also appointed a Hearing Examiner to conduct all further proceedings in this matter.

By Ruling dated March 8, 2002, a procedural schedule for the filing of testimony and exhibits was established; the matter was set for hearing on June 17, 2002, in Blacksburg, Virginia; and the Company was directed to provide public notice of the hearing on its proposed rates. On March 19, 2002, counsel for B&J filed a Motion for Extension of Procedural Schedule stating that counsel for the Company would be out of the country on the scheduled hearing date. A Ruling was filed on March 22, 2002, which superseded and replaced the March 8 Ruling. Among other things, the March 22 Ruling rescheduled the hearing to July 15, 2002.

The hearing was convened as scheduled on July 15, 2002. Edward L. Flippen, Esquire, and Paige G. Lester, Esquire, appeared as counsel for the Company. Joan G. Moore appeared *pro se.* N. Reid Broughton, Esquire, appeared for the Blacksburg Country Club Estates Homeowners' Association ("Homeowners' Association "). Rebecca W. Hartz, Esquire, appeared as counsel to the Commission. Proof of notice was marked as Exhibit 1 and made a part of the record. Post-hearing briefs were filed on August 26, 2002. A transcript of the proceedings is filed with this Report.

## SUMMARY OF THE RECORD

Three public witnesses testified at the hearing; all were opposed to the proposed increase.

Dr. F. Thomason Jannuzi, a retired economist, testified that he found the Company's proposed rates of $95.00 a month thoroughly unjustified. Dr. Jannuzi stated he was stunned recently to see that his sewerage bill of $95.00 was higher than his electric bill.[7]

Dr. Sidney S. Herman, a retired professor, was shocked to find that his monthly sewer rate was $95.00 a month compared to $30.00 to $40.00 a month charged by other utilities in the area.[8]

Pat Devens, a resident of the Blacksburg Country Club Estates, placed the blame for excessive rates on what he described as a "rogue developer" and lawyers. Mr. Devens claims that the developer is trying to reclaim his losses from developing the property through the sewer fees. Compared to other water and sewer rates in the area, Mr. Devens states that B&J's proposed rates are "totally excessive."[9]

During opening statements, counsel for B&J announced that the Company was reducing its proposed rate increase from $95.00 to $90.00 a month.[10] The Company then presented testimony from two witnesses, Burnice C. Dooley and Daina Reynolds. Mr. Dooley stated in rebuttal, that he adopted the test year ending December 31, 2001, as proposed by Staff. Mr. Dooley also stated the

[7]Tr. 5, 6.
[8]Tr. 7.
[9]Tr. 7, 8, 9.
[10]Tr. 23.

Company accepts Staff witness Armistead's adjustment to management fees. As to rate case expense, Mr. Dooley amortized the estimated cost of this proceeding over a three-year period. Because the Company is experiencing difficulties collecting its $95.00 fee, Mr. Dooley proposes a cash working capital allowance. Finally, Mr. Dooley adjusted contributions in aid of construction ("CIAC") by reflecting 42 lots required sewer mains, rather than 73 lots as used in the previous case. Based on his adjustments, Mr. Dooley's calculations reflect a 7.61% rate of return with the Company's modified rate of $90.00 per month.[11]

Daina Reynolds, superintendent of B&J and a certified operator, described his duties for the Company as follows:

- Ensure that all monthly and daily reports are completed;
- Ensure that testing equipment is operational and in good working order;
- Perform required testing;
- Ensure that all safety equipment is available;
- Ensure a safe working environment;
- Oversee contract employees; and
- Ensure that the sewer system is operational and in compliance with applicable regulations.

Mr. Reynolds testified the Company should not be required to hold connection fees in an escrow account. With this requirement, Mr. Reynolds argued, the Commission is punishing B&J for taking prudent steps to finish installing the sewer system, and minimize the overall cost of the sewerage system build-out to ratepayers.[12] Mr. Reynolds stated on rebuttal that the Company and Staff agree that the connection fees could be used to reduce Company debt.[13] Regarding rate case expense, Mr. Reynolds testified that Ms. Lester provided legal services to the Company for the regulatory proceedings during 2000 and 2001 at no expense.[14]

The Homeowners' Association presented testimony from William G. Foster and Donald P. Marks. Dr. Foster is an economist and executive vice president of Foster Associates, Inc., an independent economic consulting firm dealing primarily with energy and regulatory matters in the United States, Canada, and overseas. Dr. Foster argues the Company's proposed rate increase is neither reasonable nor just, and constitutes rate shock. Dr. Foster states B&J has inflated its rate base by significantly reducing CIAC the Company received as part of the sales agreement with the Blacksburg Country Club. Furthermore, Dr. Foster points out that the Company has included working capital as part of its rate base, a cost that was disallowed in the previous case.[15] Dr. Foster characterizes the Company's regulatory expense as "very, very high." He also takes issue with the Company's management fees and the Company's collection of connection fees.[16] Dr. Foster calculated rates of return with and without an availability fee. With a $20 availability fee, Dr. Foster arrived at a rate of $29.50 a month. Without an availability fee, Dr. Foster calculated a rate

[11]Tr. 52 – 55.
[12]Ex. 6, at 17, 18.
[13]Ex. 7, at 9.
[14]Id. at 3.
[15]Ex. 17, at 4, 5.
[16]Id. at 9-15.

of $41.40 a month. By applying an availability fee to only the lots owned by B&J, assuming 22 lots, Dr. Foster reduced the monthly rate to $38.10.[17]

Donald P. Marks helped install the original plant at B&J, and later designed and supervised the expansion of the sewer plant. He operated the plant for approximately one and a half years from 1985 to 1986.[18] Mr. Marks testified on the life expectancy of plant pumps and system operation requirements.[19] Mr. Marks also disputed Mr. Reynolds' assertion regarding the amount of time required for system operation. He testified that, on average, plant operation should require less than one hour per day in general.[20]

Staff presented the testimony of Ashley Armistead, who recommended that a record be kept of Mr. Reynolds' time and vehicle miles devoted to the Company. Mr. Armistead also recommended applying connection fee proceeds toward $206,312 of the Company debt and thereafter escrowing the proceeds for capital improvements. Mr. Armistead believes that no verifiable data exist to warrant a change in the current calculation of CIAC; however, should CIAC be recalculated, the cost of lateral lines should be included in CIAC. Mr. Armistead testified that the Company has the expertise to maintain its books in accordance with accounting requirements for Class C Utilities, and Staff is willing to assist the Company with this requirement. In conclusion, Mr. Armistead's recommendations and adjustments result in a revenue requirement of $92,394 and a rate of $58 per month.[21]

Staff witness Tufaro pointed out in his prefiled testimony that the Company is proposing an increase of 137.5% in monthly rates when the Company's current rate of $40 has been in effect only since March 20, 2001.[22] Mr. Tufaro notes that the monthly rate of $95 proposed by the Company is significantly higher than rates currently approved for other sewer companies regulated by the Commission.[23] He further states that the Company has failed to provide the required notice for the proposed tariff revisions presented in its rebuttal testimony.[24]

## DISCUSSION

To better understand the issues in this case, a review of the Company's history is essential. By means of a sales contract dated December 14, 1995, between B&J and Blacksburg Country Club, Inc., ("BCC"), B&J received a number of undeveloped lots in Blacksburg Country Club Estates ("BCC Estates") in return for: (1) paying off a $42,000 construction loan, (2) upgrading or building the roads in the subdivision to Virginia Department of Transportation standards, (3) providing sewer service, and (4) assuming all of BCC's real estate development and operations obligations in regard to all phases of BCC Estates.

[17]Tr. 298, 299.
[18]Ex. 16, at 2.
[19]Tr. 273, 274.
[20]Ex. 16, at 3.
[21]Tr. 312-314.
[22]*Application of B&J Enterprises, L.C.*, Case No. PUE-1999-00616.
[23]Ex. 15, at 3.
[24]Tr. 254, 255.

On September 2, 1999, B&J filed an application ("previous case")[25] with the Commission for a certificate of public convenience and necessity to operate the sewer system. In its application, B&J proposed a monthly rate of $34, an availability charge of $20 per month, a service connection fee of $17,500, and a disconnection and reconnection fee of $5,000.

On March 20, 2001, the Commission issued an Order in B&J's previous case, granting B&J a certificate of public convenience and necessity and establishing a monthly rate of $40.[26] On April 10, 2001, the Commission granted B&J's Petition for Reconsideration ("Petition"). In its Petition, B&J requested clarification concerning the use of connection fee proceeds and a $2,500 capital contribution from certain designated lot owners.

In its Order of May 14, 2001, the Commission denied B&J's request to apply connection fee proceeds to debt repayment and directed B&J to maintain the fees in an escrow account. The Commission allowed B&J to supplement the record on this point in its next rate proceeding (the current proceeding), and this issue is addressed below. The Commission did, however, permit B&J to collect a one-time capital contribution from certain lot owners. Approximately four months later (October 26, 2001), B&J notified its customers and the Commission of its intent to increase its monthly rates from $40 to $95, effectively initiating the current proceeding.

The standard for establishing rates for sewer utilities is set forth in § 56-265.13:4 of the Code of Virginia. This statute provides, in part, that:

> The charges made by any small water or sewer utility for any service rendered shall be (i) uniform as to all persons or corporations using such service under like conditions and (ii) nondiscriminatory, reasonable and just. Every charge for service found to be otherwise shall be unlawful. Reasonable and just charges for service within the meaning of this section shall be the lowest charges as shall produce sufficient revenues to pay all lawful and necessary expenses incident to:
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> 1. The operation of the system, including maintenance costs, operating charges, and interest charges on bonds or other obligations;
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> 2. The providing for the liquidation of bonds or other evidence of indebtedness and the attraction of capital;
>
> 3. The providing of adequate funds to be used as working capital, as well as reasonable reserves and funds for making replacements. . . .
>
> . . . .

[25] *Application of B&J Enterprises, L.C., For a certificate of public convenience and necessity to operate a sewerage utility*, Case No. PUE-1999-00616.

[26] In its Order, the Commission acknowledged the $40 per month rate exceeded the rate noticed to the public ($34), but noted that the proposed availability fee would be denied and the proposed fee for a connection would be reduced. (Order at 10).

5. Compensation of owners of the utility for their capital or property invested in the system, if any, and for their time and other resources expended in the operation of the system not otherwise recovered. . . .

*Description of Plant Facilities*

On December 14, 1995, BCC sold the sewerage system and a number of lots in BCC Estates to B&J. The sewerage system serves BCC Estates and surrounding areas. BCC Estates has approximately 245 lots (approximately 34 lots are not suitable for development). The plant is permitted for a maximum of 40,000 gallons per day. The sewerage system is composed of a treatment plant with a 50,000-gallon capacity, two gravity flow pumping stations, two force main pumping stations, and connecting mains. The plant is an extended aeration system with post-chlorination and dechlorination capability. The plant is in excellent condition and is in compliance with applicable standards and regulations.

Major improvements to the plant were completed in 1999. Since 1999, an on-site laboratory was built to facilitate testing. Also since 1999, all motors, blowers and essentially all electrical components have been replaced.[27]

*Test Year*

Initially, the Company used the year 2000 as a test year for this proceeding. Staff utilized 2001 as a test year because it has the most recent data available. Subsequently, B&J agreed to use a 2001 test year and conformed its testimony accordingly.[28] I find that 2001 is the appropriate test year for this proceeding because it provides the most current account of the Company's financial condition.

*Management Fee*

Daina Reynolds lives in Botetourt County, Virginia, and is employed by CSW Associates ("CSW"), an affiliate of B&J. B&J is owned by Mr. E. H. Lester and Mr. W. H. "Bill" Lester. CSW is owned by Messrs. Lester and two other family members. CSW leases Mr. Reynolds' services to B&J.

Mr. Reynolds holds a Class IV Wastewater Works Operators Certificate[29] and his duties with B&J include daily operation and oversight of the sewer system. Mr. Reynolds oversees all construction and testing, including preparation of periodic reports and compliance with regulatory requirements. He procures all products and chemicals and secures contract services when necessary. Finally, Mr. Reynolds handles customer complaints and is on call at all times to respond to emergency situations.

[27]Ex. 6, at 5.
[28]Tr. 71.
[29]Ex. 6, at 2.

In his prefiled testimony, Mr. Reynolds stated that, for the year 2000, $59,000 was allocated for contract services. The contract services included $43,000 of Mr. Reynolds' salary at CSW because the vast majority of his work is related to the management of B&J. Also included in the contract services was $12,000 for the services of W. H. Lester and $4,000 for bookkeeping expenses.[30]

At the hearing, Mr. Reynolds testified that his $43,000 salary was for a four-hour day or part-time work at the sewer plant. Mr. Reynolds' total salary from CSW is $63,000 or $64,000 annually.[31] Also included in Mr. Reynolds' compensation is an apartment for which B&J is paying $7,200 to CSW. The apartment will no longer be a part of Mr. Reynolds' salary as of December of 2002.[32]

In support of the management fee expense, which includes the required testing that Mr. Reynolds performs, B&J obtained an estimate from Olver Labs for the routine daily testing required by DEQ. Olver Labs currently performs monthly water testing for B&J. The estimate shows that Olver Labs would charge $38,000 annually for the daily testing alone. Mr. Reynolds pointed out that the routine testing does not cover unusual circumstances in the operation of the plant or re-testing of samples that are performed at an additional charge.[33] B&J also obtained an estimate of $5,600 per month from Petrus Environmental Services, Inc. for operation, maintenance, chemicals, and testing services for the sewer system.[34] Bids have been requested from other firms, but no responses have been received. Mr. Reynolds also mentioned the possibility of establishing an internship program with the environmental services department of Virginia Polytechnic Institute and State University ("Virginia Tech") in Blacksburg, but no contact has been made.[35]

Mr. Reynolds lives in Botetourt County and travels to the plant as often as every day of the week, but a minimum of four times a week. When Mr. Reynolds does not make the trip to the plant site, Michael Stiltner performs the required testing. Mr. Stiltner, however, is not a certified operator and cannot make adjustments as is sometimes required. Absent extraordinary circumstances, Mr. Reynolds states that his duties at the plant take between two and four hours a day.[36] Mr. Reynolds also receives help from Freddie Lovern, who is a certified Class IV operator and works for the Blacksburg Country Club. Mr. Reynolds states that Mr. Lovern is not interested in assuming full responsibility for the plant, but would rather continue to assist Mr. Reynolds.[37]

Staff determined that the Company expensed management fees of $37,650 incurred during 2001.[38] Staff witness Armistead testified that this expense primarily covers the costs of Mr. Reynolds. Mr. Armistead noted that the Company had represented to Staff that Mr. Reynolds' time spent on the sewer system had been reduced 50% during the calendar year 2002. Mr. Armistead excluded costs pertaining to uniforms and the apartment. Staff determined that a Virginia Tech

[30] Id. at 8.
[31] Tr. 206, 207.
[32] Tr. 212.
[33] Ex. 7, at 17.
[34] Id. 7, Ex. D.
[35] Id., at 17-19.
[36] Tr. 209.
[37] Tr. 214.
[38] Mr. Reynolds testified that CSW billed B&J $37,250 for management services in 2001. (Tr. 208).

student does the daily sampling for B&J and uses the apartment. The sampling costs were expensed elsewhere in contract services. The cost of uniforms was excluded because the Company discontinued using uniforms during the year 2000. Mr. Armistead adjusted the management fee expense downward to $28,033, a reduction to per books expense of $9,617.[39]

Donald Marks, testifying on behalf of the Homeowners' Association, stated that he helped install the original plant, later designed and supervised the plant expansion, and operated the plant for approximately one and a half years. Mr. Marks agreed that the current condition of the plant is very good. However, he argued that, on average, operation of the plant should require less than one hour per day. Duties would include recording the daily flow from the flow meter and taking samples of influent and effluent once a month to a lab in Blacksburg.[40]

Dr. Foster[41] objected to the Company's initial request for $55,000 in management-related fees, arguing that the management fee was set at $24,000 in the Company's previous case. Although Mr. Reynolds works for CSW, the Company's request for $55,000 represents an allocation of 79% of Mr. Reynolds' time to B&J. Dr. Foster further objected to Mr. Reynolds' mileage reimbursement for 100 miles a day 365 days a year. This represents a round trip from Mr. Reynolds' home in Botetourt County to Blacksburg at the same time that B&J is renting an apartment in Blacksburg for Mr. Reynolds. Dr. Foster stated that B&J should get a local person to run the plant.[42]

Moreover, Dr. Foster characterizes the amount of Mr. Reynolds' time allocated (61%) for inspecting the plant as exorbitant. Dr. Foster argued that no more than 25% of Mr. Reynolds' time should be allocated to the operation of the plant, resulting in a management expense of $11,032.[43]

Ms. Moore argues a management fee of $22,000 is appropriate based on Mr. Reynolds' testimony that the plant is essentially the same as it was at the time of the Company's previous case, when the management fee was set at $24,000.[44] Ms. Moore also argued that, in 2001, Mr. Reynolds hired Mr. Lovern and Mr. Stiltner to perform some of his duties, yet the portion of his salary attributed to B&J continues to increase.[45]

Company witness Dooley argues that Dr. Foster's adjustment for management fees is speculative and not supported by actual experience in operating the sewer system under current regulations. However, Mr. Dooley states that Staff's adjustment is based on the actual time requirements of operating the system. The Company accepts Staff's adjustment of $28,033 for management fee expense.[46]

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[39]Ex. 20, at 6.
[40]Ex. 16, at 2-4.
[41]Dr. Foster is a resident of BCC Estates and holds a Ph.D. in Economics from George Washington University. He has worked for Foster Associates, an independent economic consulting firm dealing primarily with energy and regulatory matters in the United States, Canada, and overseas. Dr. Foster has testified before state and federal regulatory agencies, including the Federal Energy Regulatory Commission and the National Energy Board of Canada. (Ex. 17, at 1, 2).
[42]Ex. 17, at 9, 10.
[43]Id. at 11. Dr. Foster's estimate is based on two hours per day, which includes an hour at the plant and an hour for travel, as well as managerial duties, and other responsibilities. (Homeowners' Association Brief at 6).
[44]Final Order at 3.
[45]Brief at 10, 11.
[46]Ex. 3, at 3.

To summarize the evidence, Mr. Reynolds testified that the sewer system is essentially unchanged from the previous case,[47] when the management fee was set at $24,000.[48] Although Mr. Reynolds is on call for emergency purposes, the Company represented to Staff that the time Mr. Reynolds spends on the sewer system has been reduced 50% during calendar year 2002.[49] Mr. Reynolds testified that operation of the system requires between two and four hours per day on average.[50] Mr. Marks is very familiar with the system and estimates that no more than one hour per day is required for its operation.[51]

Since the previous case, Mr. Lovern and Mr. Stiltner have been hired to assist in the duties of operating the system. Mr. Lovern is the maintenance foreman for the Blacksburg Country Club and is therefore near the plant site every day. He is also a Class IV system operator, checks on the system on a regular basis, and can perform repairs to the system. Mr. Lovern is paid $100 a month by B&J for his services.[52] Michael Stiltner performs the daily testing[53] and was paid $4,830 during the test year. The payments to Mr. Lovern and Mr. Stiltner are booked to the contract services account.

Mr. Reynolds is employed by CSW, an affiliate of B&J. His services are leased to B&J on a part-time basis, therefore, Mr. Reynolds splits his time between CSW and B&J. Although B&J is a small sewer company and not subject to the Affiliates' Act,[54] affiliate expenses are nonetheless closely scrutinized. The Commission held in *Commonwealth of Virginia, ex rel. Bruce M. Berry, et al. v. Virginia Suburban Water Company* ("*Virginia Suburban*"):[55]

> [W]e acknowledge that affiliated transactions between the Company and its parent need not be approved under the Affiliates Act, however affiliated interests should nonetheless be carefully scrutinized.

Section 56-78 of the Code of Virginia provides:

> In any proceeding . . . involving the rates . . . of any public service company, the Commission may exclude in whole or in part from the accounts of such public service company any payment or compensation to an affiliated interest for any services rendered or property or service furnished . . . under existing contracts or arrangements with such affiliated interest, if it shall appear and be established upon investigation that such payment or compensation or such contract or arrangement is not consistent with the public interest. In such proceeding any payment or compensation may be disapproved or disallowed by the Commission, in whole or in part, unless satisfactory proof is submitted to the

[47]Tr. 212.
[48]Final Order at 3.
[49]Ex. 20, at 6.
[50]Tr. 209.
[51]Ex.16, at 3. Mr. Reynolds agreed that Mr. Marks is very knowledgeable regarding the sewer plant. (Tr. 206).
[52]Tr. 133, 134.
[53]Mr. Stiltner's services were reclassified as contract testing. (Tr. 134).
[54]Chapter 4 of Title 56 of the Code of Virginia.
[55]Case No. PUE-1992-000015, 1993 S.C.C. Ann. Rep. 252, 254.

> Commission of the cost to the affiliated interest rendering the service or furnishing the property or service . . .

The Virginia Supreme Court has applied that standard even when certain affiliate arrangements are specifically excluded from the Affiliates Act.[56] There the Court stated that, "[N]othing in Title 56 prohibits the Commission from applying the same standard of proof to expenses . . . Indeed, the public policy requiring careful scrutiny of transactions between entities that have a unity of ownership applies with equal force…."[57]

The record is clear that Mr. Reynolds is employed by a firm, CSW, that has common ownership with B&J and is therefore an affiliate. The fundamental public policy enunciated by the Court requires the Commission to carefully scrutinize this arrangement because the two entities do not deal at arms' length. Of particular concern is that the Company keeps no record of Mr. Reynolds' mileage, number of trips, or time logs. It is impossible to calculate precisely B&J's management expense without this information.

Staff calculated a management fee expense of $28,033.[58] However, Staff did not consider that part of Mr. Reynolds' duties were performed by Mr. Lovern and Mr. Stiltner.[59] In the test year, Mr. Lovern was paid $100 per month ($1,200 annually) for checking on the system, and Mr. Stiltner was paid ($4,830) for performing three daily required tests.[60] I find that Staff's management fee expense of $28,033, agreed to by the Company, should be reduced by the amount paid to Mr. Lovern and Mr. Stiltner.[61] Accordingly, I find a reasonable management fee expense is $22,003.

*Rate Case and Regulatory Expense*

The Company proposes to include in rate case expense the anticipated cost of this proceeding (amortized over three years) and one-fifth of the cost of the previous case, based on the five-year amortization approved in that proceeding.[62] The Company categorizes rate case expenses into three components: legal fees, accounting support, and Mr. Reynolds' time. Company witness Dooley sets the cost of this proceeding at $51,000, allocated as follows:

| | |
|---|---|
| McGuireWoods | $25,000 |
| Dooley & Vicars | 8,000 |
| Company | 18,000 |
| Total | $51,000[63] |

[56] *Commonwealth Gas Services, Inc. v. Reynolds Metals Co.*, 236 Va. 362 (1988).
[57] Id. at 369.
[58] The Company accepts a management fee expense of $28,033. (Tr. 53).
[59] Tr. 322.
[60] Tr. 134.
[61] The expense for Mr. Lovern and Mr. Stiltner was listed and paid under the category of contract services. (Tr. 134).
[62] Ex. 4.
[63] Ex. 3, Schedule 1.

Mr. Dooley proposes to amortize the rate case expense of $76,949 from the previous case over a five-year period, resulting in an annual expense of $15,390.[64] He proposes to amortize the current rate case expense of $51,000 over a three-year period for an additional rate case expense of $17,000 annually.[65] Thus the Company seeks a total of $127,949 in rate case expense for this proceeding and the previous case.[66]

Staff recommends disallowing all rate case expense. Mr. Armistead argued that the Company has 133 customers and annualized revenues of $63,720. Rate case expense alone represents more than 200% of annual revenues. In support of its position, Staff cites *Virginia Suburban* and *Lake of the Woods Utility Co. v. State Corporation Commission,* 223 Va. 100 (1982) ("*Lake of the Woods*") in which the Commission disallowed rate case expenses as unreasonable.

In his prefiled testimony Mr. Armistead stated that Staff had, on numerous occasions requested detailed documentation to support the rate case costs incurred during the test period as well as the projected costs for the current proceeding. The Company provided documentation for legal expenses incurred during calendar year 2000 and January through August of 2001. Apparently these documents did not pertain to the present case because Mr. Armistead further testified that, "Staff learned that no estimate for the cost of the current case is available."[67] Staff further pointed out that B&J employs McGuireWoods, a large international law firm located in Richmond for representation in rate proceedings.[68]

On rebuttal, Company witness Dooley testified that the Company was unaware of Staff's request and has developed an estimate of the cost of the current proceeding.[69] The estimate of $51,000 in rate case expense for this proceeding is found in Schedule 1 of Mr. Dooley's rebuttal testimony.

Ms. Moore also argues that the Company should be denied rate case expense for this proceeding for the following reasons:

1. The accounting submitted by the Company in support of the rate increase lacks credibility and includes exorbitant and imprudent expenses;

2. B&J's customers did not request a hearing, but instead "were looking for a. . . more long-term solution. . ."

3. The Company requested a hearing by stating that if the Commission denies any part of its application, a hearing is requested; and

[64]Tr. 55; Ex. 4.
[65]Tr. 53; Ex. 3, amended Schedule 4.
[66]This includes a reduction of $52,000 from the initial rate case expense in Case No. PUE 1999-00616, the Company's prior case. The original rate case expense adjustment for the prior case was for one-fifth of $128,949.37. (Ex. 4).
[67]Ex. 20, at 7. The Company disputes this contention, stating that the information was not requested. (Company Brief at 8, n.5).
[68]Staff Brief at 9. Ms. Lester, counsel for B&J and employed at McGuireWoods, donates her services. However, other services provided by the firm are billed to the Company.
[69]Ex. 3, at 4.

4. B&J failed to prudently estimate the cost of a hearing before making the request.[70]

Homeowners' witness Foster also argues that the level of rate case expense is too high and that the Commission should not allow these expenses to be passed on to the ratepayers. Mr. Foster supports a rate case expense of $2,000.[71]

In summary, the Company proposes to amortize the estimated cost of this proceeding ($51,000), over a period of three years at $17,000 per year. The Commission previously allowed an estimated $24,000 in rate case expense for the prior proceeding to be amortized over a five-year period at $4,800 per year. The Company now states that actual rate case expense for the prior proceeding totaled $128,949.37. The Company offered to remove the rate case expense for Mr. Dye and Mr. Lester from this total, leaving a balance of $76,948. The Company requests that the $76,948 cost of the prior proceeding be amortized over five years at an annual expense of $15,390.[72] The amortization for the two rate proceedings combined would total $32,390 per year for rate case expense. B&J has 133 customers and annualized revenues of $63,720. Annual rate case expense of $32,390 equals $243.53 per year (or $20.29 per month) for each of the 133 customers. The Company's rate case expense proposal is clearly exorbitant.

In *Lake of the Woods*, the Virginia Supreme Court upheld the Commission's decision to reduce the company's rate case expense of $28,000 to $3,000. In *Lake of the Woods*, the Commission found the proposed sum excessive because it exceeded 11% of annual revenues. In this case, B&J proposes a sum that exceeds annual revenues by 200%. In *Lake of the Woods*, the Commission stated it is not required to impose upon ratepayers whatever sum a company might choose to spend for legal and accounting assistance in connection with a rate case. The Court upheld the Commission's decision and stated the Commission, "has a reasonable discretion to disallow any part of expenses actually incurred where the evidence shows such expenses are exorbitant, unnecessary, wasteful, or extravagant."[73]

It is disingenuous of the Company to request a rate increase of 138% and then contend that a hearing was not requested. Although the Commission's Rules require the Company to be represented by counsel, the cost of counsel must be reasonable. Although Ms. Lester is providing her services at no cost to the Company,[74] the overall amount of the rate case expense is too high for a utility the size of B&J. Certainly the task of separating the sewer company from the development company was an arduous task and hotly litigated, however, the resulting expense must be reasonable.

I find a reasonable level of rate case expense for the previous case to be $24,000, which is currently being amortized over a period of five years. In the current proceeding, Staff requested, but received no data to substantiate rate case expense incurred during the test period and projected costs for the current proceeding. B&J provided an estimated cost of the current proceeding of

[70]Moore Brief at 8, 9.
[71]Ex. 17, at 8.
[72]Ex. 4.
[73]*Lake of the Woods* at 110; *See Norfolk v. Chesapeake and Potomac Tel. Co. of Virginia*, 192 Va. 292, 311-12 (1951).
[74]Ex. 7, at 3.

$51,000.[75] This cost includes $18,000 for "Company."[76] No further data was provided.[77] I find a reasonable level of rate case expense for the current proceeding to be $5,000 which should be amortized over a three-year period. Total rate case expense would be $6,467 per year which is approximately 10% of the Company's annual revenues.

*Availability Fee*

The Company and the Homeowners' Association support an availability fee. The size of the lots in the Company's service territory does not allow for both a well and septic system. There is no public water system available, therefore the lots can be developed only if they connect to the Company's sewer system. Dr. Foster states that it is only fair to charge an availability fee because the owners of undeveloped lots benefit from the existence of the sewer system. Dr. Foster points out that the availability of the sewer service greatly enhances the value of a lot because without it a residence could not be built on the lot. Second, he argued it is unfair that existing residents should bear the full cost of the system. Over time, the existing customers are paying down the capital cost and thereby reducing such costs for future homeowners.[78] Dr. Foster contends that, without an availability fee, these lots continue to get a "free ride."[79]

Dr. Foster points out that the Commission, in the previous case, allowed B&J to charge an availability fee of $20.00 on its own (B&J) lots. However, he asserts that the Company subsequently removed this charge from its tariff, thereby adding over $3.00 per month to the proposed rate.[80]

Company witness Reynolds testified that owners have held the non-B&J lots for years, sometimes decades, but have not yet built dwellings on them. Mr. Reynolds argues that the value of the lots has increased significantly because of the installation of the sewer infrastructure. He states that, with few if any exceptions, these lot owners have not contributed to the support of the sewer system although mains and laterals have been extended to their lots. The Company argues the Commission has the authority to allow an availability fee for the non-B&J lots under any circumstances.[81]

Mr. Reynolds admits the Company did not implement an availability fee as permitted by the Commission in the Company's previous case. He states there are fewer B&J lots than non-B&J lots, and the B&J lots are being sold to individuals that are building on the lots at a reasonable pace. Finally, Mr. Reynolds stated the Company did not implement the availability fee on its lots because of the cost of creating an "enforceable requirement" and the administrative complexity of establishing a third category of lots for billing purposes.[82]

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[75]Ex. 3, at 5.
[76]Ex. 3, Rebuttal Schedule 1.
[77]Tr. 72.
[78]Ex. 17, at 12.
[79]Tr. 298.
[80]Ex. 17, at 13.
[81]Ex. 7, at 10.
[82]Id. at 10, 11.

In the previous case, Examiner Thomas recommended approval of an availability fee, but the Commission denied it based on lack of evidence relating to notice. The Commission held that notice is required so that a prospective purchaser would not be made a customer of the utility involuntarily. In its Order, the Commission noted that it had previously held that imposition of an availability fee is permissible only "through contract or restrictive covenant in order that purchasers of property have notice of such fees."[83]

The Commission did, however, allow the Company to impose availability fees on lots B&J owned for development and sale to the public. The Commission stated the Company could provide notice by means of a covenant in a deed of sale.[84]

The Company argues that because B&J has a certificate of public convenience and necessity to serve BCC Estates, lot owners have notice of the service territory of B&J and the jurisdiction of the Commission.[85] Citing *Application of Robert A. Winney d/b/a The Waterworks Company of Franklin County* ("W*inney*"),[86] where the Commission held that the annual availability charge would remain in effect to the extent required by a contract, covenant, equitable servitude, or the like which is independent of the Company's tariff, B&J, on brief, explores the concept of an implied equitable servitude.[87] B&J argues that an implied equitable servitude exists when a common grantor or subdivider begins to implement a scheme of development and can be imposed against all lots within the scheme, even those that have no restrictions in their chain of title.[88]

The concept of an implied equitable servitude or easement should be considered because obviously an inequitable situation currently exists. The availability of sewer service has greatly enhanced the value of the undeveloped lots. The owners of the undeveloped lots have received a benefit for which the current residents of the subdivision are paying. This is indeed inequitable and should be corrected. The current rates would be significantly lower if an availability fee were implemented and collected.[89] However in this case, the Company has failed to give notice of its tariff proposals. Therefore, the imposition of an availability fee cannot be considered in this proceeding. With proper notice to all lot owners, the Company should pursue an availability fee in a future proceeding.

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[83]Final Order at 7, 8, citing *Commonwealth of Virginia, ex re. Frank Ott, et al. v. Wintergreen Valley Utility Company*,1998 S.C.C. Ann. Rep. 352, 354.
[84]Final Order at 8.
[85]Tr. 23.
[86]Case No. PUE-2000-00665, Final Order (March 27, 2002).
[87]*Winney* Final Order at 3.
[88]Company Brief at 17, citing Michael V. Hernandez, *Property Law*, 34 U. Rich. L. Rev. 981, 984 (2000).
[89]The Company states that 79 lots are eligible for the availability fee. If the $20.00 availability fee suggested by Dr. Foster were imposed, the Company estimates the monthly residential rate would be reduced by almost $12.00. (Company Brief at 16, n.13).

*Extraordinary Repair Expense*

Mr. Reynolds testified that, in the summer of 2002, several pumps failed and the system began to back up. A contractor, Structures & Utilities Company, Inc. was called and subsequently, parts of two pair of pantyhose were discovered tangled in the pumps. After a new pump was installed, the contractor had to pump and haul backed up sewerage for two to three days.[90]

At the hearing, the Company submitted a bill dated July 2, 2002, in the amount of $15,808.15[91] for pump station repairs necessitated by damages caused by the two pair of pantyhose. The Company proposes to recover this expense over a three-year period, resulting in an annual amortization of $5,269.

Staff argues the expense should not be approved because neither Staff nor the respondents had an opportunity to review the bill, and before an extraordinary expense such as this is included in rates, the costs should be evaluated in relation to other expenses. For example, Staff argues on brief that an invoice dated March 16, 2001, marked as the first invoice in Exhibit 18, for similar services reflects much lower costs. Not only does Staff object to this item being inserted at the last minute, it has concerns about whether such cost should be capitalized or expensed.[92]

Staff and the respondents did not have an opportunity to request additional support for the invoice or evaluate its proper accounting classification. There must be a reasonable "cut off" period prior to the hearing to allow a full opportunity to evaluate all costs. In this instance the invoice was dated twelve days prior to the hearing. This is not adequate time for proper review by the Staff and parties. Therefore, I find the invoice should be excluded from consideration in this proceeding.

*Operation and Maintenance Expense*

The Homeowners' Association objects to the Company's claim of $24,928 for operation and maintenance ("O&M") expenses incurred in 2001. Dr. Foster argues the Company's average O&M expense for the three previous years was $8,147.[93] In the category of repairs and maintenance, Dr. Foster capitalized $10,146 of items that were expensed by the Company. These items include the replacement of pumps, and installation of new control panels, float switches, and a blower. He also capitalized a locking device, construction of a fence, and the planting of new trees.[94] Homeowners' witness Marks testified that the pumps and blowers should last eight to ten years and the float switches should last ten to fifteen years.[95]

Dr. Foster presented eight invoices totaling $24,675.59 collectively marked as Exhibit 18, regarding the items in question. Of this amount, Dr. Foster stated the Company capitalized approximately $14,000 and expensed the remainder.[96] Dr. Foster, in his prefiled testimony,

[90]Tr. 103.
[91]Ex. 5.
[92]Staff Brief at 21.
[93]Ex. 17, at 11.
[94]Tr. 294.
[95]Tr. 273, 274.
[96]Tr. 294.

reclassified $2,500 of the expensed portion as a capital item.[97] However, at the hearing, he advocated reclassifying the entire expensed amount as a capital item.[98]

Staff, in its prefiled testimony, reclassified $1,216 of the Company's expensed items ($10,146) as capital to cover the lawn mower, bush trimmer (or "weed eater"), and electrical work required by Occupational Safety and Health Administration.[99]

The Company opposes Staff's reclassification of expense to capital.[100] In particular, the Company claims it is unfair to capitalize the cost of a lawnmower and weed eater.

I find the cost of the lawn mower ($218.41) and weed eater (bush trimmer) ($208) should be eliminated. Mr. Reynolds testified that he had hoped to cut the grass around the pump stations with the lawn mower and weed eater, but it proved too difficult. Therefore, the area was bush hogged.[101] The invoice for the bush hogging and trimming around the pump station(s), performed by BSA Lawn Care L.L.C., is part of Exhibit 18. It is apparent this work was performed by a contractor; therefore, there was no reason for the Company to purchase a lawn mower and bush trimmer.

Upon examining Exhibit 18, I find that a majority of the expenditures should be capitalized. Specifically, the invoice dated March 16, 2001, for pump station repairs and installation of a new pump should be capitalized with the exception of $1,723.06 for pumping and hauling that should be expensed. The invoice dated February 6, 2001, for piping and replacing a pump at pump station #2 should be capitalized. The invoice dated July 9, 2001, for installation of a new control panel and float switches should be capitalized. The invoice (130379) dated November 1, 2001, for blowers should be capitalized. The invoice (1225) dated August 7, 2001 to install a locking device should be capitalized.[102] The planting of pine trees and construction of a split rail fence reflected in the BSA Lawn Care invoice dated February 4, 2001, should be capitalized, but the chipping, bush hogging and weed eating should be expensed. The invoice for a tripod dated December 19, 2001, should be capitalized. Finally, the invoice for construction of a safety enclosure dated December of 2001 should be capitalized.

In summary, of the $24,675.59 total reflected in Exhibit 18, I find that $22,512.53 should be capitalized and $2,163.06 should be expensed. Further, the cost of the lawn mower and weed eater should be eliminated.

*Recalculation of CIAC*

The Company argues the Commission erred in reducing the Company's rate base in the previous case. Therein, Examiner Thomas calculated the amount of CIAC relating to the value of undeveloped lots transferred to B&J under a sales contract with the Blacksburg Country Club.

[97]Ex. 17, at 11 and original Ex. 5.
[98]Tr. 294.
[99]Ex. 20, at 5.
[100]Tr. 53.
[101]Tr. 106.
[102]It could be argued that the pressure wash should be expensed, but the Company did not separate that amount on the invoice.

Examiner Thomas calculated a value of $210,605[103] for the undeveloped lots and included that amount as CIAC and, therefore, a reduction to rate base.

Company witness Dooley contends there are computational errors in the calculation of the $210,605 in CIAC. Mr. Dooley first believes the calculation must be updated to reflect final actual cost information. In addition, he states the calculation contained an incorrect assumption that none of the 73 individually owned lots had sewer mains available at the time of the sales contract. The Company has now determined that, of the 73 individually owned lots, only 42 required sewer main connections; the other individually-owned lots were in an old section that already had sewer mains. Mr. Dooley recalculated Examiner Thomas's figures to arrive at CIAC in the amount of $112,584.[104] Mr. Dooley agrees that if the Commission's interpretation of the sales contract is correct, $112,584 is the correct amount to include as CIAC. However, Mr. Dooley continues to believe that the Commission made an incorrect interpretation of the sales contract and that no amount of the land value should be attributed to CIAC.[105]

The Homeowners' Association objects to the Company's recalculation of CIAC. First, the Homeowners point out that the evidence supporting Mr. Dooley's recount of lots requiring main extensions was not presented until the hearing, therefore effectively denying the parties the opportunity for discovery or investigation. Further, the Homeowners contend that the value of the property received by B&J far exceeds the $210,605 approximation used in the previous case. If the issue is reopened, the Homeowners argue that the Company must demonstrate the total consideration it received and what part of that consideration is properly attributed to the sewer system as opposed to the other obligations it undertook.[106]

Staff also maintains that the Commission should not revisit its decision in the previous case and recalculate the attributable CIAC. Staff argues that Examiner Thomas, with Staff and the Company, performed the calculations to determine the correct level of CIAC.[107] In this proceeding, Staff argues that the only evidence the Company has offered is a handwritten document that provides no clear or convincing evidence that mains were installed to certain lots. Staff further argues that the Company first proposed in its rebuttal testimony to change the number of lots requiring main extensions from 73 to 42.[108]

I find the calculation based on 73 lots determined by Examiner Thomas and approved by the Commission in the previous case should not be revisited in this proceeding. Examiner Thomas worked with Staff and the Company to arrive at a $210,605 level of CIAC. In his Report, Examiner Thomas comprehensively explained his calculation of 73 lots that required main extensions. The Company participated in this calculation and apparently agreed with the outcome. In this proceeding, the Company waited until Staff and the other parties had filed testimony before it first advocated that the number of lots be reduced from 73 to 42. Staff and the other parties had

[103]Examiner Thomas used the number of individually owned lots (73) multiplied by the average cost of connecting mains to those lots ($2,885), to arrive at $210,605.
[104]Ex. 3, at 7 and Schedule 2; Tr. 54.
[105]Ex. 3, at 8.
[106]Homeowners' Brief at 11.
[107]Hearing Examiner's Report, Case No. PUE-1999-00616, at 25, 26.
[108]Staff brief at 12, 13.

insufficient time for discovery or proper analysis of the Company's new calculation. Therefore, the Company's proposal for a recalculation will not be considered in this proceeding.

*Connection Fees*

Dr. Foster listed fourteen new residences that were responsible for paying connection fees to B&J. Eight of the lots were initially owned by B&J. According to B&J responses to interrogatories, connection fees were collected on only four of the lots. Dr. Foster calculated the uncollected connection fees for 2000 and 2001 and arrived at a total of $40,500.[109] Since CIAC reduces rate base, Dr. Foster found it extremely troublesome that the largest amount of uncollected CIAC is from B&J lots. In addition, Dr. Foster contends there are two lots that should have been subject to connection fees of $7,500 in 2002.[110]

Staff witness Armistead's calculations include all connection fees actually collected by the Company from 1997 through 2001 to arrive at a figure of $131,178.[111] Staff disagrees with Company witness Reynolds' interpretation of the Commission's Order of March 20, 2001, as disallowing connection fee income the Company received prior to the date of the Order. Mr. Reynolds' interpretation of the Commission's Order would effectively exclude $133,000 of connection fees from the Company's rate base.

Ms. Moore maintains the Company has revealed previously unreported, under reported, and uncollected sewer connection fees. She contends B&J failed to disclose and credit $10,000 in sewer connection fees paid on lots 507 and 547 in 1999.

The Homeowners presented evidence that the Company has failed to collect $40,500 in connection fees and that a majority of the uncollected fees are associated with lots owned or formerly owned by B&J. Uncollected connection fees result in higher rates for the Company's customers. The Homeowners request that the Commission attribute to CIAC any fees the Company has failed to collect. Dr. Foster's testimony[112] to this effect is uncontradicted. Accordingly, I find that $40,500 in additional connection fees should be reflected in the Company's rate base.

Dr. Foster presented evidence that $7,500 of additional connection fees due in 2002 should have been used to further offset rate base. These additional connection fees should not be considered because they are attributed to the pro forma year (2002) and no other pro forma rate base adjustments have been considered. Ms. Moore argues that CIAC pertaining to two lots (507 and 547) should also be deducted from the Company's rate base. However, Ms. Moore chose not to present evidence regarding this issue and therefore, her position cannot be considered.

[109]In his prefiled testimony, Dr. Foster stated that since the previous case, the Company should have collected $58,500 in CIAC. Only $18,000 was collected during 2000 and 2001; the remaining $40,500 was not collected by the Company. (Ex. 17, at 7).
[110]Ex. 17, at 15.
[111]Ex. 20, Appendix A, Page 13.
[112]Ex. 17, at 14, 15.

*Cash Working Capital Allowance*

The Company is requesting a cash working capital allowance because many of its customers are delinquent in their payments. Since B&J is solely a sewer company, rather than a water *and* sewer company, only the sewer service can be disconnected. As explained by Mr. Reynolds, disconnecting the sewer service is difficult and involves health issues. In order to disconnect a customer from the sewer system, a balloon or similar device must be inserted into the lateral that extends from the customer's home to the connecting main. This balloon device would block the flow of wastewater from the house, resulting in a backup of sewerage from the house. Furthermore, Mr. Reynolds stated the Company would contract this service out. He estimated that the cost of a contractor to insert the balloon device would range from $1,100 to $2,330 depending on whether a manhole is available for access. This cost would increase the Company's revenue requirement because there is no tariff provision to collect the cost of disconnecting from the delinquent customer.[113]

Regardless of the Company's difficulty in collecting delinquent bills, the fact remains that the Company bills monthly in advance. Therefore, I find that a cash working capital allowance is not appropriate and should not be allowed.

*Rate Base and Rate of Return*

The Commission, in the previous case, determined that B&J's December 31, 1999, rate base was $177,698. The Commission approved total CIAC of $320,605 that included connection fees of $110,000 and a contribution related to the sale of lots that B&J acquired from the Blacksburg Country Club. The sale of the lots was compensation for extending the sewer mains to 73 individually-owned lots, providing CIAC of $210,605.

In his rebuttal testimony, Company witness Dooley proposed a rate base of $309,832 for the year ended December 31, 2001, and a resulting 7.61% rate of return.[114] Mr. Dooley noted that since its inception through December 31, 2001, the Company has accumulated losses in negative retained earnings of $270,371. He further stated the Company is financed exclusively with debt and should not be expected to operate in this manner.[115]

Staff witness Armistead calculated a rate base, after adjustments, of $206,321.[116] Based on a monthly rate of $58.00, Mr. Armistead recommends total revenues of $92,394 with a 7.62% return on rate base. Staff believes this level of income will provide reasonable cash flow for daily operations and debt service based on Staff's calculations of the note principal attributed to the Company.[117]

[113]Ex. 7, at 12, 13.
[114]Ex. 3, Rebuttal Schedule 3.
[115]Ex. 3, at 8, 9.
[116]Ex. 20, Statement 1.
[117]Ex. 20, at 15.

Based on a 2001 test year, Dr. Foster determined a rate base of $167,358. Dr. Foster included additional CIAC resulting from connection fees totaling $58,000. Dr. Foster states that only $18,000 was actually collected during 2000 and 2001, the remaining $40,500 was due but not collected by the Company. Most of the $40,500 relates to lots owned by B&J, according to Dr. Foster.[118] Finally, Dr. Foster recommends a more modest return on rate base of 4.75%, equivalent to the interest rate of the note attributed to the Company.[119]

With the additional uncollected connection fees revealed by Dr. Foster and the additional capitalized items discussed herein, I find the Company's rate base to be $175,597. This represents Staff's recommended rate base of $206,321 plus the additional capital items of $8,825 and minus the $40,500 of additional uncollected CIAC proven by Dr. Foster, net of additional accumulated depreciation and CIAC amortization.[120]

*Loan Balance/Use of Connection Fees for Debt Repayment*

The Commission, in its Order of March 20, 2001, found that, because the Company had contracted to extend service to certain lots in exchange for the real property acquired, no connection fee should be collected from these lot owners. The Commission did approve a connection fee of $5,000 for those lots that were conveyed to the Company in the sales contract between B&J and BCC and were not connected to the system. The Commission directed B&J to escrow these fees in an account to be used solely for system improvements and replacements.[121]

On April 10, 2001, the Company filed a Petition for Reconsideration stating that it had borrowed sizable amounts in order to complete the sewer infrastructure and requested that the Commission allow the connection fee proceeds to be used for debt repayment. Once all debt is eliminated, the Company proposed to then escrow the amounts collected for future system improvements.

In its Order of May 14, 2001, the Commission denied the Company's request, stating the record was insufficient to permit them to conclude that the Company borrowed sizable amounts to complete the sewer infrastructure. The Commission did, however, allow the Company to supplement the record on this point in its next rate proceeding (the present case). The Commission cautioned the Company that it might not approve the request even if an appropriate record is made tracing the funds to sewer construction. The burden of proof was placed on the Company to show why it should be allowed a full return of its investment, and essentially, a complete transfer of investment risk to its customers.[122]

In preparation for this proceeding, Company witness Reynolds reviewed all amounts borrowed on behalf of the Company and determined the portion of the original notes attributable to expenditures by B&J for sewer expansion. B&J calculated the interest attributable to the amounts borrowed and included those amounts in the Company's rate base. Based on E. H. Lester's

[118]Ex. 17, at 6, 7.
[119]Ex. 17, at 15.
[120]Hearing Examiner Statement 1.
[121]March 20 Order at 11.
[122]May 14 Order at 4.

relationship with the bank, the Company was able to obtain an interest rate of National Prime Lending Rate plus 0%. The principal amount due on this note as of March 31, 2002, is $735,813.57. The bank has advised that the Company must begin to make principal payments in addition to interest payments in order to maintain the current status of the loan.[123]

At the hearing, Company witness Dooley presented a new calculation of the Company debt.[124] Mr. Dooley admitted that $130,000 of the debt should be reclassified as a liability of the development company.[125] Mr. Dooley started with his rate base of $309,802 and added negative retained earnings of $270,371 to arrive at a total of $580,173. From this total of $580,173, Mr. Dooley subtracted $20,800 to reflect prior amortization of the $52,000 of rate case expense that the Company is no longer requesting in its cost of service, to arrive at a total debt value of $559,373.[126]

The Company requests that debt of $559,373 be recognized, or in the alternative, the Commission acknowledge that this contractual amount is independent of the Commission's jurisdiction to set just and reasonable rates.

Staff witness Armistead expressed concern with the total principal of the loan ($735,813.57) and the interest expense reflected in the Company's books. Mr. Armistead expressed further concern with the amount of rate case expense from the previous case now contained in the note and that the note may reflect non-utility related debt.[127]

Nonetheless, Mr. Armistead calculated a loan value of $206,321 to support capital improvements not funded by contributions. Mr. Armistead began his calculation with total plant costs incurred by B&J and deducted customer provided contributions and the imputed land value established in the previous case. The CIAC amount used in this calculation excludes amounts escrowed by the Company.[128] Mr. Armistead states that he does not believe the Company has provided sufficient support for the remaining loan balance.[129]

Staff believes B&J should be allowed to utilize connection fees to make principal payments on the note up to $206,321. Once this amount is paid in full, connection fees should once again be placed in the escrow account. Staff believes this action appropriate because the connection fees are designed to recover the cost of the laterals, in this instance, installed when the system was constructed. Staff believes the customers will benefit by having the note paid off as soon as possible. Further, the connection fees should continue to be recorded as CIAC which will offset the plant balance and ensure that a double recovery of this plant cost through depreciation expense does not occur.

[123]Ex. 6, at 14, 15.
[124]Ex. 21.
[125]Tr. 353.
[126]Tr. 354.
[127]Ex. 20, at 12, 13.
[128]Id. Appendix A, page 13.
[129]Ex. 20, at 13.

Staff witness Armistead further testified that his proposed revenue requirement provides for depreciation expense, which is a return of investment, in this case for the note. Mr. Armistead pointed out that his proposed revenue requirement allows operating income of $15,721 which should be used to pay interest expense and to reinvest in the utility.[130]

The Homeowners maintain that no one has given an explanation of why the utility should be responsible for the $735,813.57 placed on B&J's books or the $206,321 attributed to B&J by Staff. The Homeowners note that the Commission would not allow B&J to charge this debt to its customers in the prior case. The Homeowners argue the Company has presented no evidence to support charging any amount of the debt to its customers in this proceeding. Therefore, consistent with the Commission's prior orders, the Homeowners assert that no amount of the debt should be attributed to the utility.[131]

I find that there is a sufficient basis to support the use of escrowed connection fees to pay a portion of the debt. I find Staff's methodology of loan calculation to be reasonable; however, I find that the loan balance should be equal to the Company's net utility plant amount found reasonable herein, $175,597. This represents the amount of net utility plant that has not been funded by customer-provided capital. The Company's proposal to include negative retained earnings from prior years should not be allowed because there is no evidence supporting this proposal. The remainder of the debt should immediately be taken off the Company's books. Once the $175,597 is paid, connection fees should continue to be held in escrow to be used for capital improvements. The Company should immediately use any funds currently escrowed on its books to pay down the debt found reasonable herein.

*Number of Customers*

Company witness Reynolds testified the Company serves 129 residential customers and one commercial customer, the Blacksburg Country Club, for a total of 130 customers. The Blacksburg Country Club is then counted as three additional customers for ratemaking purposes.[132]

Staff witness Armistead testified the Company served 127 residential customers as of December 31, 2001, the end of the test year. Mr. Armistead states that the Company connected three additional customers during the pro forma year. With the Blacksburg Country Club counting as three additional customers, Staff and the Company agree on a customer count of 133 for ratemaking purposes.

Homeowners' witness Foster states there are 131 residential customers served by B&J.[133] Dr. Foster actually went to the lots with residences built since the prior case and counted residences that had inhabitants and a car.[134] With the addition of the Blacksburg Country Club as three customers, Dr. Foster's count totals 134 customers.

[130]Ex. 20, at 14.
[131]Homeowners' Brief at 4.
[132]Tr. 202; Ex. 7, at 24.
[133]Ex. 17, at 13.
[134]Tr. 299, 300.

I find the correct number of customers for purposes of this proceeding to be 133. The cut-off for new customers is the pro forma year, in this case, 2002. The customer count is properly determined by the Company's billing records that, in this case, reflect a customer count of 133 customers.[135]

*Rates*

Prior to May of 1999, the Company's monthly rate was $29.00. Pursuant to the prior rate case, the Company requested and implemented on an interim basis a rate of $34.00 effective May of 1999. The Commission authorized a monthly rate of $40.00 in its Final Order dated March 20, 2001, in the previous case. By letter dated October 26, 2001, B&J notified its customers that it would impose monthly rates of $95.00 effective December 13, 2001. At the hearing, the Company announced it was reducing its rate request to $90.00 a month.

Company witness Dooley testified that with a rate of $90.00 a month, the Company would realize a net annual income of $8,860 and a 7.61% return on rate base.[136] Mr. Dooley states the Company has been relying on debt to finance the initial capital outlay to complete the system as well as to cover historical operating losses. As discussed earlier in this Report, Mr. Dooley stated the Company has accumulated losses in negative retained earnings of $270,371.[137]

Staff recommends a monthly sewer rate of $58.00. Staff determined that the Company's current annual revenues are $63,720 after adjustments. Staff's proposed rate of $58.00 would provide revenues of $92,394 and a 7.62% return on rate base.

Dr. Foster calculated three rate levels with differences based on availability fees:

| | |
|---|---|
| With availability fee applied to all undeveloped lots | $34.15 a month[138] |
| With availability fee applied to B&J lots | $42.75 a month[139] |
| Without an availability fee | $46.00 a month[140] |

Ms. Moore concludes that the Company's rate should remain at $40.00 per month because this rate case has been caused by financial mismanagement and the unwillingness of the Company to abide by the orders of the Commission.[141]

[135]There are 129 residential customers plus the Blacksburg Country Club which traditionally counts as 4 connections for a total of 133 customers. (Ex. 19, at 4).
[136]Ex. 3, at 8.
[137]Id. at 9.
[138]Ex. 17, WGF-6.
[139]Id. at WGF-8.
[140]Id. at WGF-7.
[141]Brief at 21.

Regardless of the Company's reduction in its rate request from $95.00 per month to $90.00 per month, the Company's proposed rates clearly constitute rate shock. The Virginia Supreme Court, in *Lake of the Woods*,[142] in focusing on what the Commission had deemed to be an exorbitant rate increase request, stated:

> . . . [T]hat such an increase would be "devastating" to the Lake of the Woods community. The evidence showed that the interim rates and the pendency of this proceeding had a "depressing effect" on the continuing efforts to develop the subdivision and on the availability of mortgage money to finance residential construction. The record shows that the proposed rates are significantly higher than those in nearby areas and would probably make Lake of the Woods unattractive to prospective purchasers as well as discourage the present lot owners from building.[143]

Homeowners' witness Marks surveyed the sewer rates of other utilities in the area and found the following information:

| | |
|---|---|
| Montgomery County Public Service Authority | $29.50/month |
| Town of Blacksburg | $27.53/month |
| Town of Christiansburg | $37.20/month[144] |

Although historically the Commission does not consider the rates charged by other utilities when setting rates, comparisons are sometimes necessary in determining whether a particular utility's rate should be more closely scrutinized. Such is the case here. The Company's request for a monthly rate of $90.00 represents an increase of 125% over the previously approved rate of $40.00 a month. Clearly, the Company's proposed rate increase constitutes rate shock.

I find a rate of $50.00 per month to be reasonable. This represents a 25% rate increase over the current rate of $40.00 per month. Further, this would afford the Company a return on rate base of 7.05%.[145]

*Additional Proposed Tariff Changes*

The Company is also proposing several tariff changes:

- Codification in the tariff of the rate charged to the Blacksburg Country Club. This rate was addressed in the sales contract of December 14, 1995, and it has been customary thereafter to charge a rate of four times the residential rate.

- Clarification that the service connection fee is due when the customer's lot is connected to the main by the installation of the lateral.

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[142] *Lake of the Woods Util. Co. v. State Corp. Comm.*, 223 Va. 100 (1982).
[143] Id. at 106.
[144] Ex. 16, at 4.
[145] Hearing Examiner Statement 1.

- All reasonable costs of disconnection and reconnection would be borne by the delinquent ratepayer. The Company notes that the costs of disconnection and reconnection are significant and should not be borne by the other ratepayers.

As with the availability fee, the Company failed to provide notice as required in § 56-265.13:5 of the Code of Virginia.[146] Therefore, the proposed tariff changes may not, by law, be implemented pursuant to this proceeding.

*Booking Recommendations*

Staff witness Armistead testified that B&J has failed to comply with the Commission's Order in the previous case to conform its accounting system to Uniform System of Accounts ("USOA") requirements for a Class C Utility as required by the Commission Rules.[147] Mr. Armistead recommends that the Commission order the Company to establish its accounting system in accordance with the USOA requirements and file a letter of compliance with the Commission within three months of the final order in this proceeding.[148]

B&J proposes to include $1,200 in its revenue requirements to provide for the cost of Mr. Dooley's firm to convert the Company's accounting system to comply with USOA requirements for Class C Utilities, maintain property records, prepare the annual tax report, and prepare the annual financial and operating report for the Commission.[149] The Company contends that this is a reasonable cost to facilitate the Company's compliance with applicable requirements for which the Company's existing systems are not tailored. The Company maintains that this is a better solution than Mr. Armistead's suggestion at the hearing for the Company to prepare a "like" sheet to correlate the accounts.[150]

Mr. Armistead testified at the hearing he believes the Company has the expertise to maintain its records in accordance with the USOA requirements without added expense.[151] He further believes that if the Company's accounting system is unable to accommodate the system of accounts numbering system, a simple and acceptable alternative could be implemented. Further, Mr. Armistead states that Staff is willing to aid the Company in establishing its accounting system on the required basis.[152]

In summary, Staff makes the following booking recommendations:

- Conform its accounting system to the USOA requirements for a Class "C" Utility and file a letter of compliance with the Commission's Document Control Center within 90 days of the final order in this proceeding;

[146]Tr. 227, 254.
[147]Rules Implementing the Small Water or Sewer Public Utility Act adopted by the Commission in its Final Order of November 10, 1987, in Case No. PUE-1987-00037.
[148]Ex. 20, at 3.
[149]Ex. 3, at 1, 2.
[150]Tr. 327.
[151]Staff Brief at 18.
[152]Tr. 314.

- Write down the note recorded on Company books to $206,321 as of December 31, 2001;

- Maintain all invoices in the Company's file that pertain to both expenses and capital disbursements;

- Maintain property records on all capitalized plant items;

- Maintain a log of miles driven and reason for the trip when using a truck owned by an affiliated company, as well as a log of Mr. Reynolds' time and work performed for B&J; and

- Restate plant, accumulated depreciation, CIAC, accumulated amortization of CIAC as of December 31, 2001, to the level reflected in Column (3) of Statement III of Exhibit 20 (Mr. Armistead's prefiled testimony).

I find that Staff's booking recommendations are reasonable and should be implemented with the following exceptions: the Company should write down the note recorded on its books to $175,597 and use any funds currently escrowed on its books to pay down this amount, and restate plant, accumulated depreciation, CIAC, accumulated amortization of CIAC as of December 31, 2001, to the levels found reasonable herein. I further find that the Company, with Mr. Armistead's assistance, is capable of bringing its accounts into compliance with the requirements of the USOA for Class C Utilities. Therefore, I find the $1,200 proposed for accounting assistance is unnecessary.

## FINDINGS AND RECOMMENDATIONS

Based on the evidence in this case, I find that:

1. The use of a test year ending December 31, 2001, is proper in this proceeding;

2. The Company's test year operating revenues, after all adjustments, were $63,720;

3. The Company's test year operating revenue deductions, after all adjustments, were $67,267;

4. The Company's test year operating income, after all adjustments, was $(3,547);

5. The Company's proposal to recalculate the value of land transferred to the Company in consideration of, among other things, completing the sewer system to certain lots should be denied;

6. The Company's adjusted end of test period rate base is $175,597;

7. The Company's current rates produced a return on adjusted end of test period rate base of -2.02% during the test year;

8. The Company requires additional gross annual revenues of $15,930 which will provide a return on rate base of 7.05%;

9. The Company's monthly rate should be set at $50.00;

10. A cash working capital allowance is not appropriate and should not be permitted because the Company bills in advance;

11. The Company should be required to promptly refund, with interest, all revenues collected under its interim rates in excess of the amount found just and reasonable herein;

12. The Company's proposed tariff changes should not be allowed to take effect because the Company failed to provide the proper notice as required by law;

13. Staff's booking recommendations, except as adjusted herein, are reasonable and should be implemented;

14. The Commission should order the Company to maintain its accounting system in accordance with USOA requirements for Class C Utilities and direct the Company to file a letter of compliance with the Commission within three months of the final order in this proceeding; and

15. A loan value of $175,597 attributable to capital improvements is reasonable and the principal should be paid with connection fee proceeds, beginning with any amounts currently escrowed on the Company's books. Once the $175,597 is paid in full, the Company should place connection fee proceeds in escrow to be used for future capital improvements. The remaining balance of the note (above $175,597) should be immediately taken off the Company books.

I therefore ***RECOMMEND*** that the Commission enter an order that:

1. ***ADOPTS*** the findings in this Report;

2. ***GRANTS*** the Company an increase in gross annual revenues of $15,930;

3. ***DIRECTS*** the prompt refund of amounts collected under interim rates in excess of the rate increase found reasonable herein; and

4. ***DISMISSES*** this case from the Commission's docket of active cases and passes the papers herein to the file for ended causes.

## COMMENTS

The parties are advised that any comments (Section 12.1-31 of the Code of Virginia and 5 VAC 5-20-120 C) to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within twenty-one (21) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118,

Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,

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Howard P. Anderson, Jr.
Hearing Examiner